

FROM THE WORLD OF GENERAL INSURANCE

Asbestos developments

During April, there were several developments in the continuing saga of the proposed Fairness in Asbestos Injury Resolution Bill in the US. A group of major insurers, including AIG, Chubb, and Zurich, dropped their support for the \$140bn compensation fund, preferring to focus on setting standard medical criteria for asbestos claimants. A number of manufacturers in the asbestos industry took a similar line. The main concern they raised was whether the fund would bring complete finality to the problem. Other lobby groups have, however, confirmed their support for the proposed legislation. After these developments, Arlen Specter, the chairman of the Senate committee trying to reach agreement on legislation, stated that such agreement was now nearer than ever before. However, a few days later, a committee meeting broke up in disagreement after Mr Specter tried to introduce a provision which would allow claimants to return to court if the compensation fund was exhausted.

World Trade Center

United Airlines Inc (UA) has been thwarted in its attempt to claim lost earnings following the terrorist attacks of 11 September 2001 under the business interruption provisions of its property insurance policy. A federal judge ruled that the policy language did not cover the losses which had been experienced, and that the amount claimed was inconsistent with the damage suffered – UA has stated that an appeal will be lodged.

Contingent commissions

Willis Group Holdings Ltd has become the third major brokerage to settle with the New York attorney-general, Eliot Spitzer, in relation to its involvement in contingent commissions and other anti-competitive practices. It paid \$50m, plus a further \$1m to settle similar investigations by the Minnesota state authorities. In addition, the brokers confirmed that they ceased accepting contingent commissions from October 2004, and had made various other changes to business practices.

Finite risk reinsurances

Martin Sullivan has replaced Hank Greenberg as chief executive of AIG, and his new management team has been cooperating with Mr Spitzer and the Securities and Exchange Commission. As a result, one employee has been sacked for acting obstructively and others

have been threatened with similar action if they do likewise. Meanwhile, the AIG share price fell by approximately 30% over a period of six weeks. In view of the co-operation, Mr Spitzer has said that a civil settlement, rather than criminal proceedings, is the most likely means of finalising the investigations into AIG. In a meeting between Mr Spitzer and Mr Greenberg, the latter exercised his right to take the fifth amendment, rather than answering questions which may lead to his incriminating himself. He said he needed more time to review documents. The Bermudan regulator has also commenced investigations into AIG's involvement in, and accounting for, certain finite risk reinsurances.

Further enquiries have centred on MBIA, the leading US financial guarantee insurer. In particular, the US regulators are investigating the suitability of finite risk reinsurance provided to MBIA by Channel Re, partly owned by PartnerRe, RenaissanceRe, and MBIA itself.

Elsewhere the closure of Inter-Ocean Reinsurance, a finite risk group with companies in Bermuda and Ireland, has been linked by analysts to the focus of regulatory investigations into this type of business, and the Australian regulators launched an investigation into General Reinsurance Australia and its reinsurance practices, including its effect in helping insurers to hide losses.

Enron

A proposed \$168m settlement with Enron shareholders has been challenged by former executives of the company, on the grounds that the proposal to fund it mainly from directors' and officers' liability insurance would leave dozens of Enron officers without the cover they needed for their protection. The court has, therefore, been asked not to approve the settlement.

HIH

Rodney Adler (former director) and Ray Williams (former chief executive) of the Australian HIH insurance group have both been sentenced to four-and-a-half-year prison terms for their roles in the collapse of the group. Both had pleaded guilty to the charges; Mr Williams plans to appeal his sentence.

Lloyd's

The Lloyd's market has reported a £1.4bn pre-tax profit for 2004 (its third consecutive year of positive results), in spite of the high level of catastrophe claims, which amounted to £1.3bn

net of reinsurance. The result was also adversely affected by prior year reserve additions of £545m for the 2001 and prior underwriting years. The central fund has increased to nearly £1.2bn, following the issue of subordinated debt amounting to over £0.5bn.

Large losses

Professor William Gray of Colorado State University, an acknowledged expert in forecasting hurricane activity, has predicted an above-average Atlantic hurricane season, with seven hurricanes, and a 73% probability that at least one will make landfall in the US.

Recent notable general insurance incidents/losses include:

■ **Sudan 1 dye (late February)** The product recall cost is estimated at £100m, and this may be covered in the contaminated products insurance market. The retailers involved are likely to be self-insured, but may attempt to claim their costs against the manufacturers of the contaminated products.

■ **Texas refinery explosion (23 March)** Fourteen people were killed by the explosion at a BP America oil refinery in Texas City. Insured costs have not been disclosed, but are likely to be heavily concentrated on BP's captive insurer.

■ **Texas hailstorm (24 March)** Golfball-sized hailstones caused damage to automobiles, homes, and commercial property. Insured losses of over \$100m are likely.

■ **Japanese and Indonesian earthquakes (11 April)** Two further quakes measuring 6.1 and 6.0 respectively on the Richter scale hit Tokyo and the Sumatran coast respectively. While neither was of major direct impact, they are considered potentially important as part of the recent spate of earthquakes in eastern Asia.

■ **Japanese train crash (25 April)** A commuter train derailed and crashed into an apartment block near Osaka, killing over 100 people, the worst toll on the Japanese railways for over 40 years. It is understood that the investigations into the cause are focusing on the speed at which the train was travelling. Insured losses are not to hand at this time.

Current issues newsletter

Other recent developments are covered in the General Insurance Current Issues newsletter, which can be accessed via the profession's website at www.actuaries.org.uk/Display_Page.cgi?url=/general_insurance/gen_ins-curr-issues.html

 DAVID HART

Insurer governance developments

OECD urges insurers and pension funds to clean up their act

OECD countries have approved new guidelines for insurers and pension funds to strengthen investor and customer confidence in the insurance industry and protect people's pensions from mismanagement and fraud.

Recent scandals have revealed huge financial irregularities and highlighted the need for the insurance industry and its watchdogs to improve governance standards. The OECD calls on insurers to comply with existing regulations and urges them to put in place additional internal checks and balances to improve integrity and demonstrate a commitment to better business practices.

The 12-point *Guidelines for Insurers' Governance* provide governments and the insurance industry with a roadmap to do this and thereby better protect policyholders and shareholders. They include specific proposals for:

- The structure and responsibilities of the board, with as its primary objective the protection of shareholders and policyholders.
- The integrity and accountability of board members, who should be legally responsible for their actions and decisions.
- Strict internal control and reporting systems, that take into consideration insurance specificities and complexities.
- The appointment of an independent, external auditor to certify an insurer's accounts at least once a year, and who has the power to alert regulators to irregularities or criminal violations. The role of the actuary is also confirmed as essential for the governance of insurers.
- Clear and timely disclosure to stake-

Loads money in life and pensions

Optimistic projections of the growth potential in European life and pensions and global financial services have come from German giant Allianz and from consultant Mercer Oliver Wyman (MOW).

Speaking at the time of the Allianz AGM, CEO Michael Diekmann said: 'We believe that the biggest opportunities for growth are in the market for retirement provision and capital accumulation – particularly in Europe and the USA. In Germany and in other European countries, awareness of the gap in pension provision and the need to close that gap with private retirement provision has grown substantially during recent years. This affects around 160m people throughout the EU.

'In western Europe alone, we're expecting the volume of investment in private retirement provision products to double over the coming ten years: from around €7,000bn today to more than €16,000bn. This means huge growth potential for private as well as company pension provision', Diekmann added.

Meanwhile a report by MOW entitled 'Future of Financial Services – Future Scenarios' predicted a significantly different shape and magnitude for the world's financial services industry over the next 15 years.

Key conclusions included:

- ◆ financial services will represent 10% of global GDP by 2020 with revenue growth to \$6 trillion;
- ◆ significant value migration will take place within financial services, at individual firm, sub-sector, and geographic levels;
- ◆ macroeconomic factors will account for two-thirds of growth, with business improvement and industry innovation accounting for one-third only;
- ◆ successful companies will balance: taking positions in growth markets; managing for value growth in maturing businesses; and using dynamic hedging against potential negative market developments.

More at www.merceroliverwyman.com/en/Files/Press/Press_Release_-_FoFS_III_English_April_05.pdf

holders (such as policyholders, shareholders, and regulators) of a company's financial position and exposure to the financial and technical risks facing insurers.

- Access to prompt redress through the courts or regulators or the setting up of alternatives such as internal dispute procedures and independent arbitrators.

See www.oecd.org/dataoecd/19/10/34799740.pdf

APRA releases proposed general insurance risk and financial management reforms

Meanwhile, having regard to the HIH failure previously reported in *The Actuary*, the

Australian Prudential Regulation Authority (APRA) has issued a discussion paper, draft prudential standards and guidance notes outlining a proposed strengthening of the prudential supervision of general insurance in the areas of risk and financial management. The consultation package outlines proposals to:

- ◆ clarify and strengthen existing requirements in business planning, risk management, reinsurance management, and outsourcing;
- ◆ ensure insurers adequately document reinsurance contracts;
- ◆ introduce strict requirements for the approval of limited risk transfer arrangements;
- ◆ require approved actuaries to complete an annual financial condition report on each insurer and have a peer review undertaken of actuarial valuations of insurance liabilities; and
- ◆ require CEO and CFO attestation of the financial information provided to APRA, the approved auditor, and the approved actuary.

Details of the consultation, very different from the direction taken by the UK Financial Services Authority, can be found at www.apra.gov.au/Policy/Draft-Prudential-Standards-General-Insurance-Risk-and-financial-management.cfm.

Training accreditation scheme

The Financial Services Skills Council (FSSC), chaired by actuary David Prosser, has launched the first in a new suite of schemes designed to show where firms and training providers have achieved excellence in training. Accreditation of Training Excellence for Firms and Accreditation of Training Excellence for Training Providers are the first two

in what will ultimately be a series of five FSSC accreditation schemes. Accredited organisations will be listed on the FSSC website and will be able to use an FSSC Accreditation logo on company materials.

The first accredited schemes are Aon Reinsurance and Norwich Union (regulated sales training).

Actuaries clash in Court 76

The litigation by Equitable Life against its former auditors and directors continues, with actuaries Charles Thomson and Roy Ranson having so far taken the stand. Thomson faced cross-examination by Chris Headdon, who is representing himself.

A former Equitable Life director was told that he was being sued as a way of getting to the 'deep pockets' of Ernst & Young, according to defence documents revealed yesterday in the High Court. The chairman of Equitable Life, Vanni Treves, is said to have told John Sclater in May 2001 that he had appointed lawyers to find 'a deep pocket anywhere that could be made to pay up, for example, Ernst & Young'.

The revelation was made on the first day of Equitable's £3.75bn negligence action against its former auditors, Ernst & Young, and 15 of its former directors. Mr Treves and Charles Thomson, the chief executive, claim that poor management by their predecessors brought the mutual society to the brink of collapse in 2001, while the auditors failed to spot that the company had not put aside enough money to cover its liabilities.

The Times 12 April

A former boss of Equitable Life yesterday described the £3.7bn lawsuit brought by the insurer against him and others as a 'Frankenstein's monster that should be strangled' before it did any more damage.

Earlier, the court was told that one of Mr Headdon's predecessors, Roy Ranson, who ran the company from 1992 until 1997, had served the insurer 'with integrity', and that Equitable had been 'his life'.

The Penrose report laid much of the blame for the company's troubles at Mr Ranson's door, describing him as 'manipulative' and 'autocratic'.

Guardian 19 April

Ernst & Young, the accountancy firm, yesterday accused troubled insurer Equitable Life of 'the rankest hypocrisy' over Equitable's £2bn legal claim against its former auditor. Jonathan Gaisman QC, for E&Y, said Equitable had provided 'no smoking gun' to prove its case that E&Y should have demanded the society put aside huge provisions to cover the cost of its guaranteed pension plans in the late 1990s. Mr Gaisman attacked Charles Thomson, Equitable chief executive, saying he had filed the £2bn claim against his client on the same day as he had signed off Equitable's 2001 year-end accounts on 15 April 2002. E&Y said signing off those accounts meant that Equitable had to accept its audit of the insurer in 1999 because Mr Thomson, Equitable, and new auditor Pricewater-

houseCoopers, had not decided that those accounts were wrong and needed to be restated.

Mr Gaisman said: 'It is, shall we say, piquant that at the same time as [the current Equitable] management and PwC were satisfying themselves of the propriety of the 1999 accounts [Equitable chairman Vanni] Treves was writing to policyholders to tell them that the forensic accountancy team at PwC had raised "serious concerns" over my client's work. It does seem odd that at the same time as the society and PwC were deciding that the 1999 financials were not mis-stated (Equitable's solicitor) Herbert Smith and the people down the corridor at PwC were saying there was something seriously wrong with 1999 and the previous years' accounts.' He described the two documents signed by Mr Thomson as 'two totally irreconcilable and inconsistent statements of facts'. Mr Gaisman was particularly critical of the role played by PwC actuary David Parmee, one of the PwC experts who is likely to be called to support the Equitable claim. He worked, said Mr Gaisman, at different times, on both the forensic team that investigated E&Y's work on Equitable and on the PwC audit team.

Daily Telegraph 20 April

The chief executive of Equitable Life said on Tuesday that when he took control of the UK life insurer in 2001 he did not identify any fundamental past failures on the part of its auditors Ernst & Young.

Equitable Life pulled back from bankruptcy in 2000 and is suing Ernst & Young for up to £2.05bn (\$3.93bn) for failing to warn it of the financial abyss created by overgenerous guarantees on its insurance policies. In its key claim, Equitable Life says that a £200m provision in 1999, signed off by E&Y, to cover the risk posed by the problematic policies was inadequate.

But Charles Thomson, under cross-examination by E&Y's lawyer Jonathan Gaisman, said that when he joined the society in 2001 he did not think there was any problem with the provision. 'On the basis of what I knew at the time, I believed those figures to be sound. I did not identify a fundamental flaw at that time.'

Thomson also said, under cross-examination by Gaisman, that he had largely written a reference letter for himself when applying to work for the mutual. Thomson joined the society in 2001 as appointed actuary from rival life insurer Scottish Widows, where he was deputy CEO. He became CEO of Equitable in March 2001.

Reuters 26 April

Charles Thomson, chief executive of Equitable Life, yesterday sealed his stint under cross-examination by denying that he was the prime mover behind the mutual society's pursuit of a £3.7bn

legal claim. Concluding his ordeal on the stand, Thomson told the High Court in London that a decision of such 'significant magnitude' had to be taken at board level. He was responding to questioning by Christopher Headdon, who is a former chief executive of Equitable and representing himself.

Headdon had queried why the litigation sought to put the blame on a group of individual former directors and non-executive directors when current decisions taken by the society – such as its solvency position – were taken by the collective board. Thomson reiterated the point that he was not behind the decision to pursue 15 former directors and former auditor Ernst & Young in the courts. He said: 'It is a collective. There is no single prime mover.'

Headdon also put it to Thomson that Equitable's board had a deliberate policy since July 2001 of 'blaming the previous board with anything they possibly could'. Thomson denied that was the case.

In contrast to his dramatic appearances at the trial last week, Thomson looked more relaxed, taking his time to consider the questions and directing his answers at Mr Justice Langley. When he was dismissed by the judge, Thomson returned to the public benches to watch the remainder of the session.'

The Herald 4 May

Former Equitable Life chief executive Roy Ranson yesterday defended the troubled insurer's policy of not holding back reserves in its with-profits life insurance fund to cushion it against financial shocks. He argued that the policy was fair and the insurer believed policyholders should receive all the returns on their savings rather than their cash being used to build up a pool of reserves like rival companies. He said: 'The thought of holding anything back I find so foreign I can't get my mind around it.' Mr Ranson is one of 15 former Equitable directors the society is suing for £1.7bn for alleged negligence. It is also suing former auditor Ernst & Young for £2bn. The case was brought in the wake of the society's near collapse in 2000 after the House of Lords ruled it should pay in full guarantees to holders of guaranteed pension plans which put a £1.5bn hole in its accounts and forced its closure to new business.

Mr Ranson spelled out the policy in the 1990s in a now infamous paper 'With-Profits Without Mystery'. Victor Milligan QC, for Equitable, put it to Mr Ranson that no other company was willing to follow Equitable's policy after the paper's publication. However, Mr Ranson criticised them saying: 'With-profits insurers were not prepared to be open. We were willing to be open.'

Daily Telegraph 11 May

Down with tax barriers to European pensions!

Tax has been identified over the years as a major obstacle for market integration of occupational pensions. In April, European commissioner for taxation and customs union László Kovács received two reports on discriminatory tax treatment in respect of occupational pension funds. The reports were prepared by the EFRP and the EU direct tax group of PricewaterhouseCoopers (PwC).

EFRP chairman Jaap Maassen told the

commissioner that both EFRP and PwC are preparing formal complaints with the European Commission on the discriminatory tax treatment of pension institutions in respect of cross-border transfers of pension capital, and in respect of payments of dividends and interest to foreign pension funds (higher taxation of foreign pension funds). The details of the complaints will be made public when the complaints have been formalised.

pany accounts, an aspect that will be addressed in phase II. On assessing the current interim standard, 70% of respondents rated IFRS as being a marginal improvement, with only 12% claiming significant improvement on existing practice.

Analysts supported the efforts of the industry to build consensus around European embedded value (EEV) reporting, with the prospect of many companies producing supplementary EEV information in their reports next year; 80% of analysts rated EEV as being more useful than IFRS phase I. Moreover, almost all analysts surveyed believe EEV will improve the comparability of European life insurers' financial reporting.

However, the discussions revealed some reservations about how EEV, and in particular the risk margins, will be applied in practice. Underlying this was a certain amount of scepticism, which also emerged in relation to IFRS, about how as one analyst put it, 'companies always seem to arrive at the same number whatever the basis for evaluation'.

Infrastructure loans – investment opportunity?

Institutional investors interested in buying in to the huge loans made by banks to infrastructure projects, can get access to default and recovery ratings being provided by Standard & Poor's (S&P). According to S&P's Michael Wilkins, this move helps banks to free up their loan books to invest in even more projects. For non-bank investors, it's a burgeoning asset class, he adds.

'We're seeing an increased appetite among institutional investors to go into bank loans, both leveraged loans, and also large infrastructural loans as well as traditional corporate loans. And the reason for that is because there's a huge volume in the market and also the yields that loans provide are much more attractive for institutional investors than traditional capital market instruments', Wilkins said. 'So we're finding that it is more secondary market activity in the loan market. Institutional funds are coming in and these loans have then been bought in the secondary market and packaged up in CDOs. Or they're traded. And it's much more active now than it ever used to be. In fact, I believe around 10% to 15% of syndicated bank loans now are bought by institutional investors like pension funds.'

Pensions policy disquiet

The Association of Consulting Actuaries' (ACA) latest pension trends survey was conducted in January and February this year. Over 390 schemes, with assets exceeding £131bn and over 2.8m members, responded to a wide range of topical pension questions. This first report focuses on their views on current pension policies, the 2004 Pensions Act, and responses to ideas posed by the Pensions Commission in its initial report.

The survey reveals disquiet at the direction of pensions policy in respect of both occupational and state provision. Few firms expect the 2004 Pensions Act to contribute towards promoting occupational arrangements. Indeed, in this important area of extending occupational provision, most firms say the Act will be counter-productive. It is acknowledged that certain measures, such as the introduction of the Pension Protection Fund, may bring added security to present members of defined benefit schemes, but in other respects the 2004 Act is found wanting.

Schemes strongly support further pension reforms that will allow private schemes greater flexibility in confronting issues such as increased longevity – reforms that were largely subsumed by the protection dominated 2004 Act. Just as importantly, firms say genuine reform of the state pension schemes is essential if the private reforms are to take off.

DC lags behind DB in engaging with members

Members of defined contribution (DC) pension schemes are considerably less aware of their likely income in retirement than defined benefit (DB) pension scheme members, according to research by Watson Wyatt. In its survey, 65% of DC scheme

members have no idea or only a vague idea of their likely income in retirement, compared to 31% of DB scheme members.

According to the research, 65% of DC scheme members feel that saving enough for retirement is going to be very or fairly difficult compared to 55% of DB members. The picture looks bleaker when it comes to descriptions of their current pensions communication material and DC scheme members are considerably less complimentary than DB members. Some 44% of DB members said it was 'straightforward' compared to only 32% for DC. Furthermore, 34% of DC members said it was 'complex' (24% for DB), 24% described it as 'full of jargon' (16% for DB), and 19% of DC members described it as 'boring' (14% for DB).

Including more examples and providing help on how to plan were rated as the most important ways information about pensions could be improved for DC scheme members.

Insurance analysts support IFRS, prefer EEV

Research by PricewaterhouseCoopers reveals insurance analysts are generally supportive of IFRS phase I as a step in the right direction to enable listed insurers in the EU to prepare financial statements under one set of accounting principles from 2005.

Insurance phase I (IFRS 4) was introduced as an interim standard to deal with the immediate challenge of implementing IFRS for insurance contracts while the International Accounting Standards Board (IASB) continues to work towards a long-term phase II solution.

Unsurprisingly, analysts are concerned that in the meantime there will be a lack of comparability between insurance com-